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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In re	)	
Review of the Syndication and Financial Interest Rules, Sections 73.659-72.663 of the Commission's Rules	)	MM Docket No. 95-39

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COMMENTS OF THE

COALITION TO PRESERVE THE FINANCIAL INTEREST AND SYNDICATION RULE

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To: The Commission

COMMENTS OF THE COALITION TO PRESERVE THE FINANCIAL INTEREST AND SYNDICATION RULE

The Coalition to Preserve the Financial Interest and Syndication Rule (the "Coalition") submits these comments in response to the Commission's Notice of Proposed Rule Making dated April 5, 1995.

SUMMARY AND INTRODUCTION

The Coalition is composed of over 300 members, including established and emerging producers, independent television stations, public interest groups and consumer organizations.[1] The Coalition's members are, in short, the very parties that the Commission predicted would benefit from its decision to repeal (in two stages) the

1 A list of the Coalition's members is attached as Appendix A.

financial interest and syndication rule ("FISR" or the "Rule"). In the two years since the Commission repealed the financial interest rule, however, there has been no sign of the public welfare benefits that the networks predicted would result from the Rule's repeal. For this reason, as well as those set forth in the Coalition's earlier comments filed during the Commission's consideration of the Rule commencing in 1990 and culminating in its 1993 decision,[2] there is no basis for the Commission to conclude that the purported benefits of repealing the syndication rule will somehow materialize if the Commission permits this rule to expire, as scheduled, in November. Accordingly, the Coalition asks the Commission to take this opportunity to strengthen the FISR in certain critical respects, and to schedule it for review in 1999, when further developments in the television marketplace may warrant its relaxation or repeal.

The Commission's decision in 1993 to repeal the financial interest rule, and to provide for the automatic sunset of the syndication rule, was necessarily based on a series of predictive judgments.[3] The record at that time, as the Commission observed, contained conflicting evidence concerning the likely consequences of the Rule's repeal.[4]

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2 *Evaluation of the Syndication and Financial Interest Rules*, 8 FCC Rcd 3282, 3337 (1993) ("Second Report and Order"). The Coalition incorporates by reference herein its comments filed in that proceeding. For the Commission's convenience, particularly those commissioners who did not participate in that earlier proceeding, we attach to these comments excerpted portions of our earlier filings that provide background information on the television program production process. Appendix B, for example, provides a general description of that process.

3 *Id.* ("Our decision today reflects our predictive judgment that phased removal of constraints on network participation in the purchase and distribution of programming is likely to best serve the public interest by generating more competition in the marketplace for television programming.").

4 *Evaluation of the Syndication and Financial Interest Rules,* 6 FCC Rcd 3094, 3099 (1991) ("Report and Order").

The Commission found in its 1991 order that the networks continued to have the ability to exercise power in the market for the purchase of prime time entertainment programming, and the market for the sale of off-network syndicated programming. In the Commission's judgment, this warranted the preservation of some, but not all, of the Rule's safeguards. The Seventh Circuit questioned this judgment and, on remand, the Commission abruptly changed course; it fully embraced the networks' arguments that eliminating the financial interest rule would confer significant benefits upon producers, independent television stations and, ultimately, the viewing public.

The purpose of this proceeding is to test the Commission's 1993 predictions that beneficial effects that would flow from the repeal of the financial interest rule against the reality of the television marketplace for the last two years. [5] As the Commission observed in its reconsideration order in 1993: "we believe that what occurs in the deregulated financial interest side of the programming market will likely be relevant to our own decision to phase out the remaining syndication restrictions."[6] The Commission expressly warned the networks that "evidence of network abuses in the programming market . . . would weigh heavily against permitting the remaining rules to expire. *Indeed, such action could result in a tightening of our finsyn rules.*"[7]

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5 Second Report and Order at 3340 (purpose of proceeding is "to confirm our predictions on how the networks will respond" to the changes in the FISR adopted in 1993).

6 *Evaluation of the Syndication and Financial Interest Rules*, 8 FCC Rcd 8270, 8293 (1993) ("Reconsideration Order").

7 *Id.* (emphasis added).

The record of network behavior since 1993 plainly warrants strengthening of the Rule. None of the benefits that the networks assured the Commission would result from repeal of the financial interest rule has, in fact, come to pass. The networks have not provided increased financing and programming opportunities for the "smallest, least established producers." They have not provided better financing terms for other producers of prime time entertainment programming. Nor have they used their financing capacity to invest in "particularly risky programming." Likewise, there has been no demonstrable increase in total investment in prime time entertainment programming; nor, more importantly, has there been any increase in the diversity of program supply.

On the contrary, the record shows that the networks have reduced license fees for, and total investment in, prime time entertainment programming. At the same time, the networks have moved an increased portion of prime time production in-house, or into ventures in which they own a financial interest. These trends have resulted in a marked decline in the diversity of program sources.

This is why producers and stations alike are here -- as part of the Coalition -- asking the Commission to strengthen the FISR. It is telling that the networks have never been able to provide a satisfactory solution to the following puzzle: If repeal of the FISR will benefit producers and independent stations by fostering a more efficient television programming marketplace, then why are the beneficiaries of this action uniformly opposed to such a change? The only response the networks have ever been able to muster is an incomplete one -- *i.e.,* that certain producers (the studios) feared that they would be harmed competitively by the repeal of the FISR. Yet, as the facts reveal, it is the smaller producers who have been the immediate victims of the networks' renewed ability to exercise their market power. The uncontrovertable fact that these producers and the other purported beneficiaries of the Commission's 1993 order remain uniformly opposed to the FISR's repeal speaks louder, and more persuasively, to the ultimate issues before the Commission than any theory advanced by the networks' stable of economic theorists.

The Commission ordered this proceeding because it was well aware that its predictions concerning the effects of eliminating the financial interest rule on prime time program production could prove to be erroneous. Indeed, the Commission concluded that if network participation in program financing did not, in fact, have the beneficial consequences the networks repeatedly assured the Commission would result from repeal of the rule, it would have to reconsider its predictive judgment that the syndication rule should be repealed as well. Given that the evidence unequivocably disproves the Commission's predictive judgments with respect to the effects of repealing the financial interest rule, a decision by the Commission to permit the sunset of the syndication rule would be arbitrary and capricious. Similarly, the Commission should not, in light of its discovery that its 1993 decision was predicated on erroneous predictions, let stand its repeal of the financial interest rule.

Instead, the Commission can protect diversity in prime time entertainment programming by taking this opportunity to strengthen the FISR. Specifically, the Commission should (1) preserve the syndication rule as it exists today; (2) readopt the separate negotiation safeguard it adopted in 1991, modified to ensure that the negotiation over the acquisition of back-end rights[8] does not take place until after the network has committed to broadcast a program; and (3) limit the term in which a network may acquire program options to four years.[9] The Commission should schedule the Rule for further review in 1999, at which time it can determine whether the continuing evolution of the television marketplace warrants the Rule's relaxation or repeal. In light of developments in the marketplace to date, permitting the Commission this additional time to review the consequences of its actions can only serve to enhance the public interest in broadcast diversity.

I. NONE OF THE PREDICTED BENEFITS OF REPEALING THE FINANCIAL INTEREST RULE HAS BEEN REALIZED

When the Commission repealed the financial interest rule in 1993, it predicted that its action would have a number of beneficial consequences for the production of prime time entertainment programming. In fact, none of these predictions has come to pass.

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8 We use "back-end rights" to refer, collectively, to financial interests and syndication rights.

9 An option is the right unilaterally to renew a series. Since 1980, the networks have been prohibited from acquiring option terms in excess of four years by the terms of a provision in their respective antitrust consent decrees. That provision, however, will expire in November of this year.

A. Contrary To The Commission's Prediction, The Networks Have Not Provided Financing To The "Smallest, Least Established Producers"

At the conclusion of the 1993 remand proceeding, the Commission was "convinced that impediments to network purchase of financial interest and syndication rights have negative effects on the smallest, least established producers."[10] In reaching this conclusion, the Commission expressly rejected the Coalition's evidence that the networks would not finance programs offered by these producers: "we have no reason to believe that a network will ignore new producers in determining which producers it will finance."[11] Yet, as the record of network conduct over the last two years demonstrates, this is precisely what the networks have done.

The Coalition is not aware of a *single instance* in the last two years in which ABC, CBS or NBC provided financing for a program produced by a "small, unproven"[12] producer. On the contrary, since the repeal of the financial interest rule, the networks have provided financing only to well-established production companies, studios and experienced executive producers. For example, during the 1994-95 season, ABC teamed with Warner Bros. and the highly successful production team of Miller-Boyett *(Full*

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10 Second Report and Order at 3308.

11 *Id.*

12 *Id.* In addition, as we discuss below, only a handful of the regularly scheduled series on the networks' fall 1995 line-ups will be produced *independently* by small producers (none of whom would qualify as "new" or "unproven"). The rest of the schedule is produced by the networks and the studios.

House, Perfect Strangers) to produce *On Our Own*, as well as with Universal Television to produce *Blue Skies* (a.k.a. *A Whole New Ball Game).* Similarly, NBC Productions paired with Quincy Jones/David Salzman Entertainment (*Fresh Prince of Bel-Air*) to produce *In the House*, a half-hour, mid-season sitcom (that has been renewed for the 1995-96 season). Other network joint ventures for the Fall 1994 season included CBS Productions and Sony, which produced *Muddling Through.*[13]

The Fall 1995 season reveals the same pattern of behavior: NBC Productions has teamed with Paramount to produce *JAG*, while CBS Productions and Sony have combined to produce *Can't Hurry Love.* In addition, NBC has partnered with Turner-owned Castle Rock Entertainment (*Seinfeld*) to produce a new half-hour sitcom, *The Single Guy*, and with Warner Bros. on a potential 1995/96 mid-season replacement, *Trump Tower.*

In addition to these program-specific joint ventures, the networks have entered into a number of multi-program arrangements -- again, with established producers and production companies. Most notable among these is the partnership created by ABC and DreamWorks SKG, the entertainment company established by Steven Spielberg, former Disney studio chairman Jeffrey Katzenberg, and recording executive David Geffen in December of 1994.[14] ABC has committed to finance 50 percent of the development,

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13 CBS also combined with Stephen J. Cannell Productions, which has produced a long series of successful network shows, for the 1993/94 mid-season replacement, *Traps.*

14 Spielberg Studio Joins with Cap/ABC, Television Digest, Dec. 5, 1994, at 5. DreamWorks plans to produce movies, television shows, interactive games, animated films and musical recordings. Ronald Grover, *They're Stuffing Money Through the Studio Gates*, Business Week, Mar. 6, 1995, at 38.

production, overhead and distribution costs for DreamWorks' production of television shows.[15] DreamWorks' first series, *Champs*, is a potential mid-season entry to the ABC line-up[16] ABC has also entered into a venture to produce television shows with Brillstein-Grey (*The Garry Shandling Show* and *Alf*). That venture has already produced *Somewhere in America* and *Wilde Again* for ABC's Fall 1995 schedule.[17]

NBC and CBS have entered into similar ventures. NBC Enterprises and highly successful producer/director James Burrows (*Cheers, Frasier,* and *Friends*) recently formed a production company under a multi-year agreement. NBC and Burrows will share the equity in all of the programs that the joint venture produces.[18] The first program to emerge from this joint venture is *Caroline in the City*, which was produced in association with CBS Entertainment Productions. CBS for its part, recently signed a deal with highly acclaimed producer Steven Bochco that gives the network a fifty percent interest in the three shows Bochco will produce for CBS by the year 2000. [19]

The networks, in short, have not provided financing to the "smallest, least established producers." On the contrary, despite the Commission's skepticism in 1993,

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15 John Dempsey and Brian Lowry, *ABC Waiting to Expand Empire*, Variety, May 22, 1995 - May 28, 1995, at 37 ("ABC Waiting To Expand Empire").

16 Brian Lowry, *Disney, DreamWorks Vie for Slot as ABC Sets Sked*, Daily Variety, May 17, 1995, at 1.

17 *Id.*

18 *ABC Waiting to Expand Empire* at 37.

19 Ronald Grover, *We'd Take a Hit From Attila the Hun,* Business Week, Mar. 20, 1995, at 14.

the Coalition's prediction that the networks would "ignore new producers," and offer financing only to successful and well-established producers, has proven to be correct. The Coalition counts more than 100 of the "smallest, least established" producers among its members. These producers believe, as the record now unambiguously shows, that their prospects for securing financing have *worsened* as a result of the repeal of the financial interest rule, and will improve only if the Commission strengthens the FISR.

B. Contrary To The Commission's Prediction, The Networks Have Not Provided Better Financing Terms To Producers Of Prime Time Entertainment Programs, Nor Has There Been Any Increase In The Total Investment In Such Programs

In 1993, the Commission predicted that allowing the networks into program financing would "introduce new competition into the bidding for financial interests" among program financiers.[20] This, in turn, supposedly would have two beneficial effects: First, it would "allow program producers to seek financing of their production 'deficits' from the network carrying their programs."[21] This financing would be made available on more favorable terms because the networks, at least in their own estimation, are particularly able to bear the risks of program production.[22] Second, for the same reasons,

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20 Second Report and Order at 3301.

21 *Id.*

22 *See* Comments of National Broadcasting Company, Inc. on Second Notice of Proposed Rulemaking at 20-21; of CBS, Inc. Comments in Response to Second Further Notice of Proposed Rulemaking at 12, n. 33. In fact, because the networks "own the network exhibition rights in [prime time entertainment] programs, the eventual profits from which are likely to be highly correlated with the eventual value of the back-end rights, the networks are in the worst
(Footnote 22 Continued)

repeal of the financial interest rule would "increase overall investment in prime time entertainment."[23]

In fact, neither of these effects has occurred. On the contrary, since 1993 the networks have uniformly *lowered* the license fees they pay for prime time entertainment programming. License fees for half-hour shows, for example, have dropped dramatically. Thus, a producer who received $625,000 *per episode* in 1993 receives approximately $525,000 - $550,000 per episode today, while a producer who received $425,000 - $450,000 per episode in 1993 receives approximately $400,000 - $425,000 today. Moreover, because production costs have continued to escalate while license fees have declined, the producers' return on investment in prime time shows has declined, forcing them to reduce their overall investment in program production. Nor is there any evidence that the networks have taken steps to increase the *overall* level of investment in prime time entertainment programming. Indeed, an increasing amount of the networks' in-house production efforts in the last two years have been focused on producing lower cost magazine and "reality" shows. Thus, contrary to the Commission's

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(Footnote 22 Continued)
position to diversify away the risks associated with holding back-end rights, and thus are probably the *least* efficient source of financing for those rights." Reply Comments of the Coalition to Preserve the Financial Interest and Syndication Rule, Attachment 5 at 9 (Declaration of Frederick R. Warren-Boulton) (Feb. 16, 1993) ("Warren-Boulton Decl.") (Exhibit 1 hereto) (filed under separate cover).

23 Second Report and Order at 3301.

prediction, the networks' practices since the repeal of the financial interest rule have led to a reduction in overall investment in prime time entertainment programming.[24]

C. Contrary To The Commission's Prediction, The Networks Have Not Invested In "Particularly Risky Programming"

The Commission predicted that another benefit flowing from the repeal of the financial interest rule would be an "increase in the networks' willingness to invest in particularly risky programming."[25] There is no evidence, however, that the repeal of the financial interest rule has, in fact, resulted in network financing of "particularly risky" shows. As discussed above, the networks have shunned new producers in favor of well-established ones, and the programs they have financed comprise the situation comedies and traditional dramas that have long been the staple of prime time. Accordingly, this predicted benefit of the Rule's repeal, like the others, has proven to be illusory.

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24 The reduction in the producers' rate of return, and thus in the overall level of investment in programming, has had adverse consequences for both the quantity and quality of programming offered to the networks for broadcast. Thus, the evidence to date is consistent with the Coalition's prediction that repeal of the financial interest rule would permit the networks to exercise monopsony power. If the networks' prediction that repeal of the rule would permit the entry of more efficient sources of financing were accurate, one would expect to see the quanity and quality of programming offered to increase, not decline. *See also* n. 20, *supra*.

25 Second Report and Order at 3301.

D. Contrary To The Commission's Prediction, The Repeal Of The Financial Interest Rule Has Resulted In Diminished, Not Enhanced, Diversity

In its 1993 orders, the Commission concluded that diversity in program production is best measured by "the number of copyright holders in programming."[26] The Coalition disagreed (and continues to disagree),[27] but we nonetheless observed that if this measure is used, the most likely consequence of the financial interest rule's repeal would be a reduction in source diversity.[28] In the two years since the repeal of the financial interest rule, the networks' share of copyrights held in prime time entertainment programs increased from 29 percent to 35 percent.[29] In 1993, the Coalition pointed to the trend toward increasing network in-house production as evidence that the elimination of the financial interest rule would reduce source diversity. The Commission dismissed this evidence as "ambiguous, at best," suggesting that the trend was not likely to persist because the Commission was eliminating the provisions of the 1991 rules that gave the networks an incentive to increase the number of in-house productions.[30] Yet, since it

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26 *Id.* at 3311.

27 As we explained in our earlier filings, using the copyright methodology, Whitney Houston and Aretha Franklin would not be counted as separate artists because one recording company, Arista Records, holds the copyrights to their songs. Petition for Reconsideration of the Coalition to Preserve the Financial Interest and Syndication Rule at pp. 10-11 (June 11, 1993).

28 *Id.* at 11.

29 Data concerning copyright ownership of prime time entertainment programs for the Fall 1995/96 season is not yet available to the Coalition.

30 Reconsideration Order at 8289 n. 53.

took that action, the trend toward increasing levels of program concentration in the hands of the networks has continued unabated, with the networks taking ownership interests in approximately 40 percent of the programs added to the networks' prime time line-ups in the last two years. The Commission can reverse this trend, and thus enhance diversity as it has defined it, only by strengthening the FISR.

II. CHANGES IN THE TELEVISION MARKETPLACE SINCE 1993 DEMONSTRATE THAT CONCERNS ABOUT THE ADVERSE EFFECTS OF REPEALING THE FINANCIAL INTEREST RULE WERE WELL-FOUNDED

The Commission told the networks when it repealed the financial interest rule that it would "monitor developments in the market closely, to ensure that [its] predictions about network behavior and the effects of their behavior are accurate."[31] It then warned the networks that if they abused their newly acquired privileges, the Commission would consider "a tightening of our finsyn rules."[32]

Given this admonition, one would expect that the networks, like children who are told in December that Santa Claus will be watching them carefully until Christmas Day arrives, would be on their best behavior until November 10, 1995 (the date on which the syndication rule is currently scheduled to expire). The signs are unmistakable, however, that the networks continue to possess market power, and will exercise it if the Rule is lifted and the careful watch of the Commission is averted.

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31 Second Report and Order at 3312.

32 Reconsideration Order at 8293.

A. The Networks Continue To Dominate The Market For Prime Time Entertainment Programming

In the earlier phases of the proceeding, the Coalition established that, as a matter of both economic principle and marketplace reality, the networks continue to have market power in the market for the purchase of prime time entertainment programming.[33] The Commission at first agreed with the Coalition, but then changed its mind when the Seventh Circuit expressed doubt about the agency's conclusion. On remand from the Court of Appeals, the Commission embraced the networks' argument that other means of program distribution, such as first-run syndication and cable, represent viable alternatives to the networks for producers of prime time entertainment programs.[34]

The Coalition disagrees with this conclusion, and has witnessed no change in the marketplace in the last two years that has diminished the networks' power in the prime time entertainment program market.[35] What has changed, however, is the networks' position on this issue. In March of this year, the networks' economic consultants filed a report on behalf of the networks in the the Commission's Prime Time Access Rule

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33 Comments of the Coalition to Preserve the Financial Interest and Syndication Rule at 11-18 (Feb. 1, 1993). Warren-Boulton Decl. at 14-23.

34 Second Report and Order at 3304-07.

35 Even the growth of Fox has not had this effect. Fox has simply fallen in line behind ABC, CBS and NBC, offering no more favorable terms for the purchase of prime time programs.

("PTAR") proceeding.[36] This report, if it is accurate,[37] provides direct empirical support for the conclusion that producers of prime time entertainment programs cannot sell those programs through non-network means of distribution.

The network economists claim that when PTAR was adopted, and the networks were precluded from programming one of the four prime time evening hours, a large number of viewers simply turned off their television sets during this "access hour," rather than watch non-network shows.[38] Moreover, they claim, these viewers continue to shun non-network programming today.[39] The *only* way to provide these viewers with the programs they most highly value, the networks' economists conclude, is to allow the networks to broadcast prime time entertainment programming during the access hour.

Thus, if the networks are to be analytically consistent, this economic analysis must lead them to the conclusion that other distribution outlets, such as first-run syndication and cable, are not be substitutes for network broadcast of prime time

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36 *Review of the Prime Time Access Rule, Section 73.658(K) of the Commission's Rules*, Economists Incorporated, An Economic Analysis of the Prime Time Access Rule at 28-41 (Mar. 7, 1995). In its NPRM in this proceeding, the Commission said that it would "take notice of the record developed in our proceeding to review the Prime Time Access Rule ("PTAR") to the extent it is relevant here." *Review of the Prime Time Access Rule, Section 73.658(k) of the Commission's Rules*, 9 FCC Rcd 6328, 6334 (1994) ("PTAR NPRM").

37 Various members of this Coalition have contested the accuracy of that report. *See Review of the Prime Time Access Rule, Section 73.658(k) of the Commission's Rules* , Reply Comments of the Coalition to Enhance Diversity at 30 (May 26, 1995); Reply Comments of Viacom Inc. at Appendix A, pp. 1-12 (May 26, 1995).

38 *Id.* at 37.

39 *Id.* at 33.

entertainment programs. If they were, then these outlets would be demanding, and producers would be supplying, such programs to air against the networks in the access hour. By doing so, after all, these outlets would be able to capture all of the viewers who, according to the networks, keep their sets turned off, or currently watch programs they value less than network programs. The network economists' conclusion that these viewers continue to go unserved constitutes an unequivocal (although probably unintentional) admission that there is a separate market for prime time entertainment programming in which the networks are the only effective purchasers.

B. In The Absence Of The FISR, The Networks Are Likely To Exercise Their Market Power

The available signs all point to the conclusion that the networks have every intent to exercise their market power fully once the Commission has removed the remaining restrictions and has averted its careful watch. First, as discussed above, the networks have continued to push license fees ever downward, even at a time when the costs of inputs into the production process are rising and the networks' revenues and profits are escalating.[40] Second, the networks are taking financial interests, either through co-productions or in-house productions, in an increasing number of shows. Indeed, they have done so in approximately 40 percent of new shows picked up since the Commission eliminated the financial interest rule in 1993. As a result, in the Fall 1995 season, the

40 J. Max Robins, *Nets, Producers Face Off as Fee Fight Foes,* Weekly Variety, May 8, 1995 at 29; *Ross Roy Heads for Omnicom in $50M Deal*, Advertising Age, May 22, 1995 at 2.

networks will have a financial interest in over 30 percent of the *entire* prime time schedule.[41] As one veteran network executive recently put it: "This is all a game of leverage, and when you have it you use it."[42]

Seeing these unmistakable signs, producers have begun to look for ways to escape the effects of the networks' market power. Two large producers have attempted to integrate forward into network broadcasting by starting new networks; [43] others have been rumored to be considering an acquisition of one of the networks.[44] These efforts are expensive and highly risky. Whether they will ultimately prove successful remains to be

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41 Brian Lowry, *WB Packs Primetime Wallop,* Daily Variety, May 25, 1995, at 1.

42 J. Max Robins, *Nets, Producers Face Off as Fee Fight Foes*, Weekly Variety, May 8, 1995, at 30.

43 The networks undoubtedly will claim that the launch of The WB and UPN constitutes evidence that the remaining FISR restrictions should be eliminated. In fact, these developments prove exactly the opposite. First, Warner Bros. and Paramount (in a joint venture with Chris-Craft Industries) began their efforts to build new broadcast networks in an attempt to ensure that there would be outlets for their programs in the wake of the Commission's 1993 decision to phase-out the FISR. Ronald Grover, *'We'd Take a Hit Show from Attila the Hun,'* Business Week, March 20, 1995, at 34; Brian Lowry, *Networks Play Host to an Odd Bedfellows Ball,* Daily Variety, May 24, 1995, at 23. Their actions are perfectly consistent with the Coalition's prediction that, absent the FISR, the networks would be better able to exercise their market power. (It is noteworthy, moreover, that these actions are *in*consistent with the networks' predictions concerning the FISR's effects.)

Second, these two start-up networks are, as the Commission has recognized, only "incipient networks," with limited schedules and less than nationwide reach. PTAR NPRM at 6355. As a result, they do not yet (and may never) place a significant competitive constraint on the established networks.

44 Linda Grant, *A TV Network May Change Ownership* , U.S. News & World Report, December 26, 1994, at 70; Diane Mermigus, *CBS, Group W Eyed As A Good Marriage* , Electronic Media, May 8, 1995, at 2.

seen. What is clear, however, is that the option of vertically integrating into broadcasting is not available to the vast majority of producers.

Producers who lack the resources to attempt to escape the networks' power, have found that they are increasingly being shut out of the prime time line-up. Since the Commission first relaxed the FISR in 1991, the portion of the prime time schedule produced by smaller entities has fallen by almost 30 percent, while network production has increased to make up most of this gap.[45] Indeed, only a handful of the regularly scheduled series in the Fall 1995 season will be produced independently by smaller producers. Some small producers have simply stopped pitching shows for network prime time exhibition.

All of this, of course, is the antithesis of the Commission's stated objective in repealing the financial interest rule. The Commission predicted that its action would result in the networks acting as a new, lower-cost source of financing for producers, particularly the smaller, least established ones. As a result, the Commission thought, producers would enjoy a lower cost of capital, and would have greater incentives to invest in the development of additional higher quality programming. In fact, precisely the opposite has occurred. Given this experience, there is no basis for the Commission to conclude that these adverse trends will abate if the syndication rule expires. A decision by the Commission to allow the syndication rule to expire, therefore, would be arbitrary and

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45 *See* Studio production, which the networks predicted would suffer in the wake of the financial interest rule's repeal, has remained constant or increased since the Commission's elimination of the financial interest rule.

capricious and unsupported by substantial evidence. The only way for the Commission to reverse these marketplace trends -- trends that have demonstrably diminished diversity in program production -- is to strengthen the FISR.

III. THE FISR SHOULD BE STRENGTHENED, NOT REPEALED

As explained above, none of the predicted benefits of repealing the financial interest rule has materialized. Under these circumstances, it would be arbitrary and capricious for the Commission to repeal, rather than strengthen, the FISR. Instead, the Commission should take this opportunity to strengthen FISR in three respects:

First, the Commission should preserve the syndication safeguards that are currently in place. As even Judge Posner recognized, the potential costs to the networks of these safeguards are not "very great, or even substantial."[46] The potential benefits for first-run syndicators and independent television stations, in contrast, are enormous.

Second, the Commission should readopt a modified version of the separate negotiation safeguard it originally adopted in 1991. Under this safeguard, the networks are permitted to finance prime time programs so long as they negotiate for the show's back-end rights in a separate negotiation. In order to ensure that this safeguard is effective, however, the separate negotiation must take place *after* the network has

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46 *Capital Cities/ABC v. FCC,* 29 F.3d 309, 316 (7th Cir. 1994). In light of the marketplace evidence confirming the inaccuracy of the networks' predictions of efficiencies flowing from the financial interest rule, even Judge Posner's estimate of the potential costs to the networks of preserving the syndication rule must be discounted significantly.

committed to air the show. [47] In comments the Coalition submitted in the earlier phases of this proceeding, we explained in detail why this approach -- an approach first proposed by the Department of Commerce -- would allow the marketplace to realize any efficiencies that would flow from network participation in program financing, while simultaneously preventing the networks from exercising market power.[48]

Third, the Commission should impose a four-year limit on the term in which a network may acquire program options. This safeguard is currently embodied in the antitrust consent decrees entered by the networks, but will expire in November 1995. Even with this safeguard in place, it is only at the end of four years that a producer of a successful show can hope to negotiate a production agreement that reflects the full measure of the price a producer would receive in a truly competitive marketplace -- because it is only at this point that a producer has, for the first time, the realistic option of

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47 The failure to structure the safeguard in this way was the fundamental flaw in the Commission's 1991 decision. Having concluded that the networks had the ability to extract back-end rights from producers prior to committing to air a program, the Commission then adopted a 30-day separate negotiation safeguard that, in the vast majority of cases, would have expired *prior* to the time network committed to air a program. The Coalition petitioned for review of the Commission's order, arguing that its failure to adopt an adequate separate negotiation safeguard was arbitrary and capricious. The post-commitment safeguard, in contrast, is narrowly tailored to permit the marketplace to capture any efficiencies while preventing the exercise of market power. (For a more detailed discussion of the separate negotiation safeguard, see Appendix C.) The record in this matter amply supports its adoption of a properly structured separate negotiation safeguard.

48 *See* Petition for Reconsideration of the Coalition to Preserve the Financial Interest and Syndication Rule (filed July 8, 1991) at 13-18 and Appendices C and D (attached hereto as Appendix C). *See also* Warren-Boulton Decl. at 34-40. The fact that the networks vehemently oppose this proposal demonstrates in the clearest possible way that it is the exercise of market power, not the realization of efficiencies, that motivates the networks' desire to abolish FISR. *See* Warren-Boulton Decl. at 41-42.

switching to another network. Stated differently, it is only when the option terms expire that the networks compete in acquiring programs. If this option term limit is not preserved, the networks will undoubtedly increase the number of option terms they insist upon in program negotiations. Thus, in the absence of this strengthening of the Rule, the networks will be able to use their market power to extract even more onerous terms from program producers, and delay for a period of additional years, if not forever, the time when a producer can finally negotiate competitive terms.

The Coalition recognizes that the Commission may, despite the record in this matter, permit the syndication rule to expire in November. If the Commission decides to take this ill-advised course, then the Coalition believes that it should (1) retain the anti-warehousing rules; (2) readopt anti-favoritism rules;[49] (3) retain and strengthen the reporting requirements so that the networks' marketplace practices can be monitored more effectively; and (4) monitor and review the effects of the repeal of the FISR. There is no plausible objection to the adoption of these safeguards, as they simply prohibit the networks from engaging in conduct they claim they will never engage in, and require the networks to file periodic reports with the Commission. To protect the public interest in broadcast diversity, the Commission should also review the effects of its decision to determine whether it has, in fact, had the beneficial consequences the agency predicted.

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49 The Commission imposed appropriate anti-favortism safeguards in its 1991 order. *See* Report and Order at 3136.